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No. 54

In the

Supreme Court of the United States

OCTOBER TERM, 1963

UNITED STATES OF AMERICA,
Petitioner,

v.

DOROTHY ANNE STAPF AND B. T. WARE, II,
EXECUTORS AND TRUSTEES OF THE ESTATE
OF LOWELL H. STAPF, DECEASED, AND
DOROTHY ANNE STAPF, INDIVIDUALLY,
Respondents.

RESPONDENTS' PETITION FOR REHEARING

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Respondents.

RESPONDENTS' PETITION FOR REHEARING

Respondents pray that this Court grant rehearing of its opinion and decision of December 2, 1963, and that upon such rehearing the decision be modified and that it be directed that judgment be entered herein allowing a marital deduction for the property passing to Mrs. Stapf and the marital bequest arising through the debt and ~~extreme~~ EXPENSE assumption, subject to the limitation that the total marital deduction shall not exceed one-half the adjusted gross estate.

PRELIMINARY STATEMENT

Respondents accept as correct the Court's conclusion that the assumption provisions of the will with respect to the community debts and administration expenses constitute a marital bequest or gift to the surviving wife rather than creating deductible claims and expense in the decedent's estate. Respondents continue to urge, however, that such bequest, together with the testamentary devise of specific property to the surviving wife, qualifies for the marital deduction subject to the limitation that the total marital deduction cannot exceed one-half the adjusted gross estate.

GROUNDS FOR REHEARING

I.

In treating the property received by the children's trust as passing from the decedent through the wife, the opinion repudiates the controlling law of Texas, recognized by the Court, and effectively imposes an estate tax in decedent's estate on property never included in his estate.

II.

In holding the benefit to the surviving wife is the measure for determining herein the amount of the marital deduction, the opinion erroneously construes the marital deduction statute and the congressional intent in the adoption of such provision.

ARGUMENT IN SUPPORT OF GROUNDS FOR REHEARING

The decision erroneously treats two separate occurrences, each separately subject to different taxes (i.e., estate and

gift taxes), as one single occurrence subject to a single estate tax, whereby $106,268.00 passed from the deceased husband to his surviving wife under his will as a devise and the surviving wife surrendered her property of a gross value of $129,052.00 and a net value of $111,443.00

Such treatment violates the controlling Texas law of property rights recognized in the opinion. The opinion correctly states the applicable law on page 10 as follows:

> "Under a community property system, such as that in Texas, the surviving spouse receives outright ownership of one-half of the community property and only the other one-half is included in the decedent's estate. To equalize the incidence of progressively scaled estate taxes and to adhere to the patterns of state law, the marital deduction permits a deceased spouse, subject to certain requirements, to transfer free of taxes one-half of his non-community property to his surviving spouse."

As determined by the Court of Appeals herein (R. 71) and conceded by the Commissioner (page 5, note 4, of Petitioner's Brief), under the law of Texas the devise of 1/3rd of the whole community to the widow did not pass to her under the will, but was satisfied out of her own 1/2 of the community property. *Jones v. State*, Tex. Comm. of App. 1928, 5 S.W. 2d 973, and *Calvert, Comptroller v. Fort Worth National Bank*, Tex. Sup. Ct. 1962, 356 S.W. 2d 919. Thus, the only property passing from the decedent to the surviving widow was 1/3rd of his separate property and 1/2 the automobile of the value of $22,366.66 and the $17,610.00 debt assumption held by this Court to be a marital bequest.

This Court, in adopting Petitioner's characterization of the will as making a devise to a surviving spouse on condition that she "convey" property to a third party, necessarily recognizes that Mrs. Stapf, and not Mr. Stapf, made the transfer of her property to the children's trust. This is necessarily so because the title to Mrs. Stapf's 1/2 interest in the property was fully vested in her as is recognized by this Court, and such property was "conveyed" to the children's trust only as a result of her voluntary election to take under the will. It was her election and not the provisions of the will that "conveyed" *her property* to the children's trust. Her election, necessarily made after the death of the decedent, constituted the gift. There was no exchange of property between the testator and the surviving wife. By electing to take under the will, the widow's property did not become a part of the decedent's estate and taxable in his estate. GCM 7773, CB IX-2, Page 426, Ruling 33-4750. *Coffman-Dodson Bank & Trust Co., Executor*, 40 B.T.A. 890; *The Pacific National Bank of Seattle, Executor*, 40 B.T.A. 128; *Merten's Law of Federal Gift and Estate Taxation*, Sec. 11.02, Vol. 1, Page 687.

To say, therefore, as the opinion variously and contradictorily says, that the decedent devised part of Mrs. Stapf's own property to her, or to say that the decedent transferred part of his property to the children "through" the surviving wife, or that the *decedent* effectively transferred part of Mrs. Stapf's property to the children repudiates the recognized and controlling provisions of Texas law.

Treating the $17,610.00 debt and expense assumption as a marital bequest, as well as the $22,366.66 bequest of decedent's separate property and his community interest in the family automobile, as passing to the surviving wife under the will of the decedent, as is required by Texas law, the amount of the fully vested property transferred or "conveyed" by the surviving wife is $45,151.00, representing the difference between her 1/2 of the gross community property in the amount of $129,052.00 and $83,901.00 being 1/3rd of the gross community property remaining after satisfying special bequests first provided for in the will.

Such a transfer or conveyance to third parties is recognized by all as having gift tax consequences.

The fact (if it is a fact) that under the gift tax statute the surviving wife may be entitled to deduct, in determining her taxable gift, what she received from her husband, does not warrant or authorize the imposition of an estate tax in the decedent's estate on the property received by the surviving spouse under the decedent's will in the absence of clear statutory language in the estate tax statute so requiring such an imposition. As held by the Court of Appeals herein, this is a matter for Congressional action.

By denying a marital deduction, for property passing from the decedent to the surviving spouse an estate tax, at estate tax rates, is effectively levied on property that is subject only to gift tax consequences and the property passing to the surviving wife is actually taxed twice, once in the decendent's estate and again in the estate of the surviving spouse. By the adoption of the marital deduction provisions

in the Revenue Act of 1948, Congress directed that such property so passing should only be taxed once for estate purposes and not twice as was the case during 1942 to 1948, and as will be the case under the decision herein.

Respondents respectfully submit that for this Court to assume that only $5,175.00 of Mrs. Stapf's gift to the children's trust, instead of the full gift of $45,151.00, will be subject to gift tax, is to prejudge and decide such issue before such question has been presented for decision.

In determining the gift tax liability of a surviving wife who elects to take under her husband's will, the question of whether the amount received by the wife under the will can be deducted from the amount which she gives out of her separately owned community property to a testamentary trust has never been presented to this Court for decision. One Circuit Court opinion and three Tax Court opinions,[1] none of which have been reviewed by this Court, so hold. The correctness of such decisions is open to question. None of these cases involve the exact fact situation here presented. For this Court to conclude that Mrs. Stapf's gift of $45,151.00 will escape gift taxes on $39,976.00 (value of the property passing from the decedent) is to approve the holdings of the lower courts on such question before such issue is presented to this Court.

By treating any part of the *decedent's* property as passing to the children's trust *through* the surviving wife, and by

[1] Commissioner of Internal Revenue v. Siegel, C.A. 9, 250 Fed. 2d 339; Chase National Bank, 25 T.C. 617, reversed on other grounds 259 Fed. 2d 231 C.A. 5; Zillah Mae Turman, 35 T.C. 1123; Estate of Lillian B. Gregory, 39 T.C. 1012.

treating the $106,268.00 estate owned by the widow after her election as being *devised* to her by her husband, the opinion not only fails to properly apply Texas law but fails to effectuate the purpose of Congress in repealing the 1942 Amendment to the estate tax statute and adopting the marital deduction provisions in the Revenue Act of 1948.

Prior to 1942 an estate tax was levied, in a community property state, on only the decedent's one-half interest in community property and upon such separate property as he might own. Section 402 of the Revenue Act of 1942 amended Section 811 (e) of the Internal Revenue Code of 1939 by levying an estate tax upon the entire community of both spouses upon the death of the first of such spouses to die. The Congressional purpose in the 1942 amendment was described in *Fernandez v. Wiener*, 1945, 306 U.S. 340, as being "* * * the elimination of what was believed to be an unequal distribution of the tax burdens of estate taxes* * *."

As appears from Senate Report 1013 of the Committee on Finance and House Report 1274 of the Ways and Means Committee, the 1942 amendment not only failed to produce geographical equalization but produced other results, detailed in such reports, even more undesirable which led to the recommendation by both such committees that the 1942 amendment be repealed and the marital deduction provision here in issue be adopted.[2]

[2] See Senate Report 1013, Section VIII, B, Pages 1188, 1189, U.S. Congressional Service, Part 2, Eightieth Congress, Second Session, 1948, and House Report No. 1274, Section VIII, B, Page 1272, U.S. Congressional Service, Part 2, Eightieth Congressional Service, Second Session.

In the "Summary of Changes in Existing Law" in Senate Report 1013[3] it is stated:

> "The 1942 amendments to the estate and gift taxes which provided special rules in the case of community property are repealed* * *. Generally, this restores the rule by which estate and gift-tax liabilities are dependent upon the ownership of property under State law. Thus, in community property states, irrespective of which spouse dies first, only one-half of the community property is included in the gross estate."

The Respondents respectfully submit the opinion herein effectively amends the estate tax statute by failing to fix the estate tax liability in accordance with the ownership of property under the law of the decedent's domicile where all the property was located.

With due deference to the Court, it is submitted that a reading of the entire Senate Report 1013, insofar as any reference to estate and gift taxes is made, reflects an intent that the net value of the property passing from the decedent, and not the net benefit to the surviving spouse resulting from a family transaction in which her property passes to third parties by reason of her election, is the standard for measuring the permissible marital deduction.

This intent is emphasized when it is considered that the proper application of State law, governing the ownership of property and its passage under a will, does not treat, contrary to the treatment herein, any of the surviving wife's community property as passing from the decedent to her and does not treat any of the surviving wife's community

[3] Senate Report 1013, Section II, B, Page 1167, U.S. Congressional Service, Part 2, Eightieth Congress, Second Session, 1948.

property as passing to third parties from the decedent through her, but treats such property as passing *from her* and not from the decedent *through her*.

For convenience Respondents are copying as Appendix A to this motion that portion of Supplementary Report 1013 of the Senate Committee on Finance under Part II, Subpart 2, directly dealing with Subparagraph E of Section 812(e) (1) appearing at page 1227-1228 U. S. Congressional Service, Part 2, Eightieth Congress, Second Session, 1948. This excerpt should be read in context with the remainder of the Report, however, to gain the full import.

It is to be noted that Clause (i) of Subparagraph E of Section 812(e) (1) of the Revenue Code refers to "net value to the surviving spouse of such interest", whereas Clause (ii) refers to "the amount of a gift to such spouse of such interest."

Clause (i) relates to the effect that estate and inheritance taxes, levied directly upon and with respect to the property passing to the surviving spouse, have upon the value of such property and requires that the material deduction be reduced by the amount of such taxes since they are a charge upon the property itself, actually reducing the net value that can pass or be received. The meaning is clarified by Section 812(d) of the Code, reference to which is required by the statement in the Senate Report which reads:

> "This provision is substantially the same as that provided in Section 812(d) of the Code, relating to bequests, etc. to charity."

Such Section 812(d) clearly refers to taxes that are payable out of the specific bequest, devise or legacy, thereby reducing the actual value of the property received. The purpose of the provision and all reference to the "net value to the surviving spouse" are clarified in the statement in the Senate Report referring to Clause (i): "This provision is designed to prevent any implication that such taxes should not be taken into account where such taxes and the marital deduction are mutually interdependent."

The Senate Report describes Clause (ii) as requiring a different standard of measurement in valuing interests passing that are subject to encumbrances or obligations. Such standard of measurement is "as if the value of a gift to the spouse of an interest passing were being determined."

The illustration of mortgaged property passing to the surviving spouse makes it clear that the value of the property is reduced by the amount of the mortgage unless the executor is directed to discharge the mortgage from other property. The illustration of property being given to the wife subject to a charge on the property for the payment of $1,000.00 to X is no different in purpose. If the obligation to X is that of the decedent or a charge on the property, the value of the property passing is necessarily reduced by such $1,000.00 payment, whether paid by the Executor from the property with only the net value thereof passing or paid by the surviving wife out of the gross property passing. This is apparently the type of situation contemplated by the illustration. In a common law state this would be

required because usually all property passes by the husband's will, and any payment by the wife would have to be made out of such property unless she had separate property.

The actual value of property included in the gross estate and passing under the will is unaffected by the fact that the wife makes payment to a third party out of her separate funds if the payment to such third party was not an obligation of the decedent or a claim upon his estate. The Committee Report is carefully worded, and the fact that the illustration does not require the payment to X to be made out of the wife's separately owned property is clear evidence that the committee did not have in mind the construction placed upon such illustration by the opinion herein.

Respondents' contention that the illustration of the payment to X refers to the payment of a claim against, or an obligation of, the decedent, is fortified by the explanatory paragraph that follows the illustration. It is there stated "The interest passing to the surviving spouse from the decedent is only such interest as the decedent can give." This is followed by an illustration comparable to the illustration of the payment by the wife to X. It is pointed out that if a decedent leaves the residue of his estate to his surviving wife and she pays, or the estate income is used to pay, claims against the estate so as to increase the residue, such residue is acquired by purchase and not by bequest. Accordingly, the value of the additional part of the residue so acquired by purchase cannot be included in the marital deduction.

The illustrations used in the Senate Report clearly evidence that the Senate Committee on Finance was thoroughly familiar with the established rules of law for measuring the amount of a gift for gift tax purposes. Respondents know of no statutory provisions or any decision that fixes or establishes a standard for determining the amount of a taxable gift to a wife different than the standard used for measuring a gift to any other person. Neither the Government's brief nor the opinion herein refers to special rules for measuring the amount of a gift to a wife. *Lowndes & Kramer, Federal Estate and Gift Taxes*, 1962 Edition, Page 684, Section 32.4, citing *Commissioner v. Wemyss*, 324 U. S. 303, 307-308, accurately states the rule as follows:

> "According to the Supreme Court the consideration necessary to prevent a taxable gift must not only be adequate and full and capable of expression in money or money's worth, but it must also take the form of a benefit to the transferor rather than a detriment to the transferee."

The same rule is stated in *Commissioner of Internal Revenue v. Bristol*, CCA 1st, 121 Fed. 2d 129, cited in *Commissioner v. Wemyss*, and is further illustrated in *Estate of Koert Bartman*, 10 T.C. 1073; *Estate of John M. Goetchins*, 17 T.C. 495; and *Estate of B. Gwinn*, 25 T.C. 31; and *Wachovia Bank & Trust Co. v. United States* (Ct. of Cl. 1958) 163 Fed. Supp. 832. To same effect see *Mertens' Law of Federal Gift and Estate Taxation*, Vol. 1, Page 287, Sec. 5.11 and Vol. 5, Page 92, Sec. 34.18.

Under the rationale and direct holding of *Commissioner v. Wemyss*, the transfer or conveyance by Mrs. Stapf to the

children's trust was not a consideration in money or money's worth passing to Mr. Stapf that would reduce, for gift purposes, the taxable value passing to Mrs. Stapf. Since the standard for measuring the value of the property passing for marital deduction purposes is the value or amount of the property transferred for gift tax purposes, the amount of the property passing under the decedent's will should be measured by the value of such property and not by the net benefit to the recipient.

Regulation 108, Section 86.3, applicable to the 1939 Code (Sec. 25.2611-2 of current regulations applicable to 1954 Code), referring to the gift tax states:

> "(a) In general. —The tax is not imposed upon the receipt of the property by the donee, *nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer*, nor is it conditioned upon ability to identify the donee at the time of the transfer. *On the contrary*, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, *is measured by the value of the property passing from the donor*, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable." (emphasis supplied)

Thus, if any effect is to be given to the last part of Clause (ii), as must be done, the gift tax statute, the regulations thereunder and the decisions construing the gift tax statute appear to the Respondents to require that the marital deduction be allowed for the actual value of the property passing, and not merely for the resulting benefit to the surviving spouse remaining after she in turn has voluntarily

made a taxable gift of her separately owned property to a third party where such payment constituted neither an encumbrance nor obligation of the decedent.

To construe the illustration of the payment to X or the language in Clause (ii) of the statute, "with respect to the passing of such interest," as referring to the net benefit received by the wife, creates an irreconcilable conflict with the last part of such clause, requiring the encumbered property, or property subject to an obligation, to be valued "as if the amount of a gift to such spouse of such interest were being determined". Furthermore, a conflict is thereby created with the controlling cases holding that the amount of a gift, for gift tax purposes, is not to be measured by the net benefit to the recipient but by the amount of property actually transferred reduced only by a monetary consideration passing to the donor.

Since such illustration is, to say the least, subject to conflicting constructions, Respondents submit that same should be construed in harmony with the statutory language requiring the property passing to be measured as if the amount of a gift to such spouse of such interest were being determined.

Respondents respectfully submit that the Court is in error in its statement, "Respondents' construction of Section 812(e)(1) would nevertheless, permit one-half of a spouse's wealth to pass from one generation to the other without being subject to either gift or estate taxes," even if you assume the widow's gift to her children is reduced for gift tax purposes by the devise to her of a part of her husband's

property. The tax free passage of *one-half* of the decedent's property, would occur only where, 1. the decedent owned *only* separate property in which the surviving spouse owned no interest, and 2. the surviving wife owned *only* separate property, not affected with a community property interest or any other interest in her husband. Such a rare situation, though unlikely to occur, could arise in either a community property state or a common law state with equal frequency.

In a community property state, no property could be transferred free of tax if all of the property was community property, which is the usual situation, because no marital deduction would be available. If any community property is owned and the husband additionally owns separate property, the maximum marital deduction would not in any case exceed one-half of the value of the husband's separate property. If in a common law state the wife owned no separate property, there would be no property that she could transmit or convey by gift, and, therefore, no property would pass free of gift taxes.

It is further submitted that the Court's conclusion based upon the statement in 76 Harvard Law Review, 1671, 1675, that the adoption of the Respondents' position would create an "opportunity for tax reduction" that "would be more readily available to couples in community property jurisdictions than to couples in common law jurisdictions" is erroneous. As we have seen, "such an opportunity for tax reduction", in any amount, can occur in a community property state only where the decedent owns separate property, in which the surviving spouse has no interest

whatsoever, and can occur in a common law state only where the wife has separate property in which the husband has no interest or right of control. Since the author of the Harvard Law Review does not quote statistics to establish that there are more husbands in community property states who own separate property than there are wives in common law states who own separate property, the Law Review writer's conclusion accepted by this Court is open to question.

CONCLUSION

It is respectfully submitted that the Court's conclusions: 1. that any part of the surviving wife's community property was devised to her by her husband, and 2. that the will passed or had the effect of passing any part of the surviving wife's separately vested community property to third parties, and 3. that the decedent passed any of his property or his wife's property through the surviving wife to the Trustees for the benefit of the children, are all contrary to the recognized and established law of Texas governing the ownership of property and the passage of property by will, resulting in the improper denial of the marital deduction with respect to property of the decedent passing to the surviving wife under State law, upon which law the estate tax liabilities are dependent and are fixed. For the reasons herein advanced, Respondents additionally submit this Court erred further in concluding that since the surviving wife received no net benefit, the estate is entitled to no marital deduction.

Respondents pray that a rehearing be granted, and that upon rehearing, it be ordered, adjudged and decreed that

a marital deduction in the amount of $39,963.00 be allowed, subject to the limitation that such marital deduction shall not exceed 1/2 the adjusted gross estate, and that this case be remanded for proceedings in accordance with such decision.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I hereby certify that the foregoing PETITION FOR RE-HEARING is presented in good faith and not for delay.

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APPENDIX A

Extract from Supplementary Report 1013 of Senate Committee on Finance, Part II, Subpart 2, pages 1227-1228, United States Congressional Service, Eightieth Congress, Second Session, 1948.

Subparagraph (E) of section 812 (e) (1) specifically provides for the application in determining the value of any interest in property passing to the surviving spouse of rules which are generally applicable in determining the net value of any gift or bequest. Clause (i) of such subparagraph requires that there shall be taken into account the effect which the amount of any estate, succession, legacy, or inheritance tax may have upon the net value of any interest in property passing to a surviving spouse. This provision is designed to prevent any implication that such taxes should not be taken into account where such taxes and the marital deduction are mutually interdependent. This provision is substantially the same as that provided in section 812 (d) of the code, relating to bequests, etc., to charity. The rule applies where the burden of a death tax falls upon the surviving spouse or the property in which an interest passes to the surviving spouse.

Clause (ii) of such subparagraph (E) directs that in determining the value of any interest passing from the decedent to the surviving spouse, incumbrances or obligations shall be taken into account in the same manner as if the value of a gift to the spouse of the interest passing were being determined. This is a clarification which was not expressed in the bill as passed by the House. If the decedent by his will leaves to his surviving spouse real estate subject to a mortgage (whether or not such mortgage was personal liability of the decedent) the value of the interest passing to the surviving spouse does not under this section include the mortgage. If, however, the decedent by his will

directs the executor to pay off the mortgage, such payment constitutes an additional interest passing to the surviving spouse. If the decedent bequeaths certain property to his surviving spouse subject, however, to her agreement, or a charge on the property, for payment of $1,000 to X, the value of the bequest (and, accordingly, the value of the interest passing to the surviving spouse) is the value, reduced by $1,000, of such property.

The interest passing to the surviving spouse from the decedent is only such interest as the decedent can give. If the decedent by his will leaves the residue of his estate to the surviving spouse and she pays, or if the estate income is used to pay, claims against the estate so as to increase the residue, such increase in the residue is acquired by purchase and not by bequest. Accordingly, the value of any such additional part of the residue passing to the surviving spouse cannot be included in the amount of the marital deduction.